

REMARKS

This responds to the Office Action mailed on August 27, 2008.

Claim 34 is amended. Claims 1-38 are now pending in this application.

§101 Rejection of the Claims

Claim 34 was rejected under 35 U.S.C. § 101 as being directed to non-statutory subject matter. Claim 34 has been amended to expressly recite two concrete, tangible and useful elements as part of a system. An interest bearing gift card (IBGC) and a sponsor hub computer are recited, making it clear that the sponsor hub computer performs several functions. Both elements are devices and clearly within the statutory categories. The IBGC is a card adapted to be used in a point of sale device as claimed. It is a physical thing, and cannot be characterized as simply data per se. In fact, since it does contain data, it is a memory device. As claimed, the IBGC has stored information that causes point of sale devices to interact with the programmed sponsor hub computer. Since both programs stored on a memory device and data structures stored on a memory device have been found statutory, the IBGC element by itself is clearly statutory. Further, programmed computers are also statutory. It is respectfully requested that the rejection be withdrawn.

§112 Rejection of the Claims

Claims 32 and 34 were rejected under 35 U.S.C. § 112, second paragraph, for indefiniteness. This rejection is respectfully traversed.

The Office Action indicates that there is no particular structure in claim 32 capable of providing features associated with a balance, such as a stored balance, how the value of the balance came to be, or where the funds came from. This assertion is respectfully traversed, as a programmed computer is clearly recited, and a person having ordinary skill in the art would easily understand how to keep track of an account balance and apply debits and credits. There are hundreds, if not thousands of financial institutions using computers to provide these features for other types of accounts. The structure providing these functions is expressly recited as a programmed computer. It would be very clear to a person having ordinary skill in the art how to program the computer to perform these routine functions. Since every type of account has a

starting balance, and may have subsequent transactions that are updated by a computer, it is well known how to program a computer to perform those functions. Many such programmed computer claims are written in a similar format, mainly specifying the functions performed by the computer, rather than reciting specific pieces of code that perform the functions. Such claims are clear to a person having ordinary skill in the art. It is respectfully requested that the rejection be withdrawn.

Claim 34, as amended, is believed to clearly set forth an apparatus.

§103 Rejection of the Claims

Claims 1-38 were rejected under 35 U.S.C. § 103(a) as being unpatentable over Slater (US 6,615,190) in view of Carroll et al. (US 2002/0023026). The rejection is respectfully traversed.

Neither reference describes a gift card, much less an interest bearing gift card (IBGC) as claimed. Slater describes a stored value card where an employee receiving the card “may not deposit funds into the account” Col. 2, lines 37-38. See also the Summary of the Invention, Col. 1, lines 55-57, Col. 3, lines 33-34. The stored value card includes the card holder name as indicated in Col. 3, lines 47-48. Slater characterizes the stored value card in that “it may look like a credit card to an ordinary observer, but with no credit line, and may function like a debit card, but with no associated cardholder deposit account. Such a stored value card issued by a sponsoring entity may reduce handling costs of checks and paper processing for both an issuer and a recipient.” Col. 6, lines 21-26. Thus, Slater distinguishes Slater’s version of a stored value card from credit and debit cards, teaching that Slater’s stored value cards are significantly different than credit and debit cards.

The Office Action indicates that the term “gift” is not taken to positively require any particular limitation. The Office Action does point out that Slater teaches various scenarios where such an account/value card is presented to a recipient, including: relocation expenses, incentive/rewards, as a coupon or for other reasons, all of which are taken to be examples of gifts and are therefore representative of gift card accounts. This assertion is respectfully traversed. None of the scenarios described in Slater can be characterized as describing a gift card. The scenarios are described in summary in Col. 6, lines 50-56: “(1) payroll applications; (2) business

expense reimbursement and prepaid business expense applications; (3) relocation applications; (4) private label applications; (5) government benefit applications; (6) insurance applications; (7) consumer promotion applications; and (8) incentive/reward applications.” Employees do not consider a paycheck, or a reimbursement a gift. Government benefits are not gifts, nor is an insurance payment. Consumer promotion and incentive rewards are not gifts, but inducements to buy goods and services. No one would consider these types of stored value cards as gift cards. The primary purpose of the stored value cards in Slater was to replace paper checks and reduce costs. There is no suggestion that the cards are gift cards.

The Office Action has separated the word “gift” from the term of art: “gift card”, which is a well known construct in the financial industry. By separating the words, the Office Action makes a broad assertion that since a stored value card may be “given” to someone for various reasons, that makes it a gift card. This is simply not true.

The background of the current application in Paragraph [0005] states: “From the retailer’s side, what began humbly enough as the paper gift certificate, a service convenience that helped ensure the future sale would benefit the merchant, has grown into a huge business of retailer-specific plastic wallet-sized charge cards, credit cards and gift cards.” This language helps point out the significant difference in origin and function of typical gift cards and other types of stored value cards. In the financial community, gift cards are considered very different from other stored value cards such as debit cards. Debit cards generally require approval based on credit rating and agreements, as illustrated by the Bank of America Deposit Agreement and Disclosures brochure provided in a prior information disclosure statement. Gift cards have historically not required any such form of agreement. They may be given by a third party, unencumbered by such agreements. Since credit is not an issue, they may be given to people that do not qualify for credit or debit cards.

Several references of record describe the unique aspects of gift cards, and how they are treated and considered quite differently than other types of stored value cards.

Exhibit 1 is a report from the Federal Reserve Bank of Kansas City, “The Many Uses of Stored-Value Cards” At Your Service – Fall 2003. This report describes several different types of “stored-value cards, including gift cards, teen cards and payroll cards.” It goes on to talk about the features of different stored value cards. The report makes it clear that there are

different types of stored value cards, and even references the fact that a stored value card can be given to a recipient, yet does not call such a card a gift card.

Exhibit 2 is a report entitled “A summary of the Roundtable Discussion on Stored-Value Cards and other Prepaid Products.” On page 7, in underlined text, the report points out the different types of prepaid cards, such as gift cards, payroll cards, flexible spending accounts, etc. It is important to note that these are all considered different types of cards having different functions. On page 2, the business case is described as varying “significantly by product type, such as gift cards and payroll cards.” Restrictions on obtaining banking services are pointed out on page 3, such as age restrictions and poor credit history. Prepaid cards, such as gift cards can serve this underserved market. Further difference are highlighted on page 5, with respect to providing periodic statements to gift card holders. “Participants also noted that providers have no way of knowing the identity of the gift card receiver and often do not track the identity of the gift card purchaser...” These statements point out that payroll cards, like the Slater stored value card, and gift cards, vary significantly, have different business cases, and may have different regulatory restrictions.

Applicant provides the above articles as examples of some of the differences that may be found in various types of cards. As can be seen, there are significant issues associated with gift cards and other prepaid cards in general, and they are thought of quite differently by those of skill in the art. It may also be significant to note that none of the discussion at the round table that occurred a few years after the priority date of the present application, discussed or suggested any form of interest bearing gift card as claimed.

Consequently, the reports of Exhibits 1 and 2 clearly indicate a teaching away from the claimed interest bearing gift card. The report of Exhibit 2 on page 2 states that “prepaid products are less profitable to issuers than other payment instruments such as credit or debit cards.” As pointed out above, the prepaid products being referred to here include such instruments as gift cards. The Applicant respectfully submits that if the profitability of gift cards is thin without the payment of interest thereon, then such a gift card would have seemed to be even less profitable if interest is paid on the funds associated with the gift card. This decrease in profitability clearly teaches away from a gift card that pays interest to the holder of the card. The report further states on page 4 that uncertain legal and regulatory conditions vis-à-vis gift cards may stifle

innovation in the industry. The Applicant respectfully submits that this is a contributing factor to the absence of an interest bearing gift card before it was invented by the Applicant.

While Slater does indicate that interest may be paid to a card holder, this is likely the result of the sponsor of the card using the card to pay employees, and being able to negotiate for such interest payments. Such a scenario does not exist with gift cards, which are more likely given by someone as a gift, and not as salary or reimbursement.

Other art of record describes aspects of gift certificates, which are precursors to gift cards. U.S. Patent No. 6,370,514 to Messner relates to gift certificates, where interest earned by the funds of the gift certificate are retained by the issuer of the gift certificate. If the gift certificate is never used or expires, then the funds associated with the gift certificate remain with the issuer of the gift certificate. This type of profiting is fundamental to prior art gift cards.

The Office Action combines Carroll et al., with Slater to provide the claimed sub accounts, with the rationale for the combination being that since Slater already provided interest, it would have been obvious to allow the account holder to “take more of stake in realizing the revenue generating power of the float already provided by Slater.” Slater actually discourages such a combination by not even allowing the holder of the card to contribute additional funds to the stored value card. The ability to interact with ATMs and point of sale devices are expressly described, but these are all ways to take money out of the account. Since Slater describes a replacement system for payroll and reimbursement checks, there would be no reason to provide a holder with additional sub accounts as claimed. In fact, even referring to the balance as a “float” characterizes the account as something to be spent, not a savings vehicle where investment options would make sense. Thus, there is no reason to combine the references.

Also, as previously pointed out, Carroll et al., simply describes a gift certificate that is merchant specific, and can only be invested into a separate account. It is not a gift card as claimed.

Claims 14-16, 29-31 were rejected under 35 U.S.C. § 103(a) as being unpatentable over Slater in view of Carroll et al. and Armes (US 2001/00347200). This rejection is respectfully traversed. Claims 14-16, 29-31 depend from claims which are already believed allowable and should be allowable for at least the same reasons.

CONCLUSION

Applicant respectfully submits that the claims are in condition for allowance, and notification to that effect is earnestly requested. The Examiner is invited to telephone Applicant's representative at (612) 373-6972 to facilitate prosecution of this application.

If necessary, please charge any additional fees or credit overpayment to Deposit Account No. 19-0743.

Respectfully submitted,

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Date 10-1-2008

By



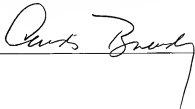
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CERTIFICATE UNDER 37 CFR 1.8: The undersigned hereby certifies that this correspondence is being filed using the USPTO's electronic filing system EFS-Web, and is addressed to: Mail Stop Amendment, Commissioner for Patents, P.O. Box 1450, Alexandria, VA 22313-1450 on this 1st day of October, 2008.

CANDIS BUENDING

Name

Signature



The Many Uses of Stored-Value Cards

Stored-value cards are not a new concept. For example, the prepaid phone card has been around for at least a decade. However, in the last several years, stored-value cards have taken on new forms and uses. Today, there are electronic benefits transfer (EBT) cards, gift cards, payroll cards and even “teen” cards (usually purchased by a parent on behalf of a teenager). With more than 6 million stored-value cards issued in 2002, they have become a viable alternative payment option.

Stored-value cards are access

devices used to deduct
money from a nonbank,
nonchecking account.

However, the cards are

funded through traditional

means such as checking

accounts, ACH funds

transfers, credit cards,

debit cards or cash.

Although nonbank entities such as Stored Value Systems, Metavante, WildCard Systems and others are prominent issuers of stored-value products, financial institutions (FIs) have begun to offer them as well. National examples of FIs offering stored-value cards include Bank of America, National City and U.S. Bank. A few examples exist in the Tenth District, one of which is TriCentury Bank in Simpson, Kan., a \$2.5 million bank.

Benefits to FIs

From an FI's perspective, offering stored-value cards helps attract new customers and provide an alternative acquisition tool for those that do not qualify for traditional credit or debit card products. In addition, it enables FIs to create a new stream of incremental and recurring revenue from usage and interchange fees generated from transactions.

Stored-value cards can either be single purpose (closed loop) or multipurpose (open loop). Single-purpose cards, such as store and EBT cards, are good only at a specific retailer or group of retailers — hence the phrase “closed loop.” In a closed-loop transaction, a nonbank service provider issues cards on behalf of its customer. When consumers use these cards to purchase goods, the service provider authorizes the transaction against a proprietary database and debits the “prefunded” account for the amount of the transaction. In essence, the transaction stays on the store's books.

FIs typically offer the multipurpose variety of stored-value cards, including gift cards, teen cards and payroll cards. These types of cards are issued with card association branding, such as Visa®, MasterCard® and Discover®. Therefore, they are accepted anywhere the association brand is accepted, making them “open loop.”

FI offerings

Bank of America and National City are among FIs that offer association-branded, stored-value cards that can be purchased in various increments and given as gifts or rewards. Two types exist: non-personalized cards, which can be purchased and given instantly, and personalized cards, which can be embossed with the name of the recipient and even a message. The cards can be used virtually anywhere, but once the funds have been exhausted, value cannot be reloaded. FIs charge a fee for the cards that may vary based on the card's denomination. Additionally, each time the card is used the FI earns transaction revenues.



Our Payments System Research staff is committed to researching emerging payments issues and providing you with regular updates. The staff is composed of (from left) Richard Sullivan, economist; Stuart Weiner, vice president and economist; Terri Bradford, consulting analyst; and Fumiko Hayashi, economist.

Among FIs offering the teen cards is U.S. Bank, which provides the Visa Buxx card. Parents often like these cards because they provide a means to teach their teens about managing their finances in a controlled way. The card purchaser determines the value to be loaded and can monitor spending behaviors and even receive e-mail alerts when purchases are made at some types of retail locations. In addition, a PIN can be requested when the card is ordered, making the card ATM-accessible. When a purchase is made, the amount is deducted from the card balance. And when the balance is low, the card can be reloaded. As with other stored-value cards, FIs earn fees when funds are loaded to the card from external accounts, transactions occur at ATMs and the point of sale, paper statements are generated and cards need to be replaced.

Tenth District product

In the Tenth District, TriCentury Bank has developed a payroll card product called the *Power eCard*. Its product is a PIN- and signature-based MasterCard branded card targeted at employers with blue collar and immigrant workers who currently receive paper checks. Unlike many other payroll card programs, TriCentury's product results in the bank opening an individual "electronic only" demand deposit account (checks cannot be written against it) for each participating employee. As a result, the individual is provided with an insured bank account that has debit and signature point of sale capabilities, and ATM features.

The *Power eCard* has other unique features. For example, if an employee who uses the card leaves his or her employer, he or she can set up direct deposit at the new employer. In addition, the card allows the employee to add an authorized user to the account. In terms of advantages TriCentury's product offers, the employer receives the benefit of being able to direct deposit payroll and therefore save on costs associated with paper checks. The employee receives the benefits of convenience, safety and lower transaction fees as compared to check cashing, purchasing money orders and wiring funds. Plus, TriCentury benefits from the additional fee and interchange revenues the use of the card generates.

The last decade has witnessed the evolution of the stored-value card. And more change is on the horizon. BankOne, for example, is working with Starbucks Coffee Company to launch the first of its kind, dual-purpose credit card for a retailer, one that functions both as a stored-value card at Starbucks outlets and as a standard credit card. When used as a credit card, card carriers will earn Starbucks points that can then be used to make future Starbucks purchases. It will be interesting to see whether this type of card will be as well received by consumers as existing ones. ■

THE FILES

In the Tenth District, TriCentury Bank has developed a payroll card product called the *Power eCard*. Its product is a PIN- and signature-based MasterCard branded card targeted at employers with blue collar and immigrant workers who currently receive paper checks.



A Summary of the Roundtable Discussion on Stored-Value Cards and Other Prepaid Products

Industry Overview | Major Themes | Conclusion

As part of an ongoing program to discuss payments system developments and barriers to innovation with a range of parties, the Federal Reserve System's Payments System Development Committee (PSDC) hosted a roundtable discussion with industry leaders on stored-value cards and other prepaid products.¹ The roundtable discussion was held at the Board of Governors of the Federal Reserve System in Washington, D.C., on November 12, 2004. The roundtable focused on current and emerging designs for stored-value and prepaid products, lessons learned from the evolution of prepaid cards over the past few years, and emerging trends in usage. The participants also discussed challenges to future development.

The discussion began with an overview of the stored-value and prepaid industry, including market developments, current trends, and expected areas of growth. Following the overview, twelve industry experts, representing retailers, processors, networks, banks, and the legal profession, provided the PSDC with insights into these developing payment instruments.² The participants discussed three overarching issues: the business case for prepaid cards, infrastructure issues, and the legal and regulatory environment. This document summarizes the industry overview and the major themes from the roundtable.

Industry Overview

For purposes of the roundtable, the terms "stored value" and "prepaid" were specifically defined. The term stored value was associated with products for which prefunded value is recorded on the payment instrument. The term prepaid was associated with products for which the prefunded value is recorded on a remote database, which must be accessed for payment authorization. So defined, the term prepaid describes most of the products on the market today. There are a variety of applications for prepaid cards, including gift cards, payroll cards, flexible spending account cards, government benefit cards (such as food stamps), insurance claim cards, employee reward cards, travel cards, remittance payment cards, and transportation cards. Most prepaid cards serve a single purpose, but there are a few cases in which multiple prepaid functions are combined on one card. In addition, some cards, such as payroll cards, government benefit cards, and transportation cards, can be reloaded with value, while other cards, such as travel cards, insurance claim cards, and most gift cards, cannot.

Prepaid cards have largely served as a replacement for paper-based payment instruments and related devices, such as gift certificates, paper tickets and tokens, and check-based rebates. Closed-system prepaid products began in the early-1970s with transit and college campus cards.³ In the late 1980s, prepaid phone cards emerged in the United States, followed by closed-system gift cards in the mid-1990s. Open-system prepaid cards began in the early 1990s with Electronic Benefits Transfer cards replacing paper-based food stamps. Open-

system gift cards were introduced in the mid-1990s. The highly-visible but unsuccessful VisaCash and Mondex stored-value card trials took place in Manhattan, N.Y., in 1997. Since the mid-1990s, providers have developed open-system prepaid cards designed to streamline payroll disbursements, facilitate remittance payments by immigrants to relatives through ATM networks, and simplify the disbursement of funds from pretax flexible spending accounts for health care expenses. Overall, closed-system products have been in existence for several decades and have been relatively successful in meeting particular market needs. In contrast, open-system products are still developing, and some providers are struggling to establish viable business cases.

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Participants in the prepaid market include end users, banks, processors, and networks. End users, which include employers, employees, retailers, and consumers, buy or sell the various prepaid products. Banks typically issue open-system prepaid products and provide services, including risk management and settlement of underlying payments, to end users (their customers). Processors offer services to banks and end users that include the processing of payment transactions, such as providing real-time payment authorizations and managing customer service call centers. Networks provide, among other services, the connection between the retailer or ATM and the processor for authorization of payment transactions. The parties to a prepaid transaction can realize different benefits, such as increased convenience, cost savings, or revenue generation, but can also face challenges, such as achieving a sustainable business case, funding system upgrades, and navigating an evolving legal and regulatory environment.

Although the overall popularity of prepaid products was noted as rising, participants predicted in the near term that the market would be fragmented and that sustained profitability may be limited to certain applications. At the same time, participants believed that there would be ongoing experimentation with products. Participants also thought that the most successful prepaid products would likely be closed-system gift cards, payroll/general purpose cards for the underbanked, remittance cards, and medical benefit/flexible spending account cards.

Major Themes

Business Case

Participants noted that, in general, prepaid products are less profitable to issuers than other payment instruments such as credit or debit cards. The profitability of prepaid cards appears to vary significantly by product type, such as gift cards and payroll cards. Profitability can also vary within the same product category, as in the case of gift cards. A participant reported that closed- and open-system gift cards have very different revenue and cost structures and that profitability for open-system gift cards in particular is limited. Another participant made the point that customer acceptance of gift cards does not indicate acceptance of all prepaid products and that acceptance will likely vary by individual product.

One participant suggested that some open-system providers are currently offering prepaid products at little or no profit because they see long-term potential for these products. Participants also mentioned that issuers and processors are developing agreements to share the implementation risk of prepaid products to help spread potential losses if they are not successful. Participants generally agreed that prepaid programs can be costly to operate. For

instance, open-system providers find it challenging to recover customer service and marketing costs, which participants identified as two significant costs associated with prepaid cards. In addition, most prepaid cards have not achieved the same economies of scale as credit or debit cards. One participant suggested that in the future there may be a consolidation of processors leading to greater scale economies. One participant also emphasized the need to partner with providers to help defray costs.

Several participants expressed concern about fraud risks associated with open-system prepaid cards. Participants specifically cited fraud risks with transactions that occur internationally where fewer retailers perform on-line payment authorizations if the transaction value is under a certain value threshold. One participant noted that because profit margins for prepaid products are slim, even small fraud losses can adversely affect the business case for offering prepaid products.

At the same time, several participants were optimistic about the future development of the prepaid card market. One participant predicted that upcoming innovations would lead to more business-to-business prepaid products and more multifunction cards. Another participant believed that closed-system gift cards and flexible spending account cards showed the greatest potential for achieving a profitable business case. This participant, in particular, believed that regulatory changes could create significant opportunities to create new prepaid products, especially products related to health care.

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Participants also thought that the underserved market represented a significant opportunity for providers of prepaid products. An industry representative defined the underserved market as consumers who chose not to use banking services, who are only allowed to use specific services because of age restrictions, or who are unable to access banking services because of poor credit history or legal status in the United States. This participant believed that prepaid cards offered underserved consumers the ability to make Internet payments--purchases and bill payments--and to learn about financial transactions, fostering financial literacy and potentially facilitating the introduction of these consumers into the financial mainstream.

Payroll cards were specifically highlighted as one opportunity to aid the underserved. One participant, however, raised concerns about the value of payroll cards for this group. This participant's company had apparently chosen not to issue payroll cards to its employees because the company believed that the cost of the cards to the employees was higher than available alternatives. For example, providers may charge the cardholder fees to access the customer service call center, to withdraw funds at a bank branch or through a nonaffiliated ATM, and to make purchases at the point-of-sale. This participant estimated that the cost to recipients could potentially be hundreds of dollars annually depending on the program. One participant also thought that users of payroll cards were often unaware of these fees.

Infrastructure

In general, the dual existence of closed- and open-system gift cards, which use different infrastructures for processing, has created challenges for retailers, issuers, and payment networks. Participants mentioned that consumers' expectations have often been set from their experiences with highly developed closed-system gift cards and that consumers expect similar services from open-system gift cards. Significant infrastructure investments, however, may be necessary to ensure that open-system gift cards function similarly to closed-system

cards. In particular, open-system systems have typically been designed to process credit or debit cards and are still evolving in their processing of prepaid cards.

One participant, for example, mentioned the challenge of processing open-system gift cards when the amount of the purchase is greater than the balance on the card. In a closed-system gift card transaction, the balance on the card is automatically checked during the purchase. If the amount of the purchase is greater than the balance, the retailer will debit the gift card balance and use another payment method for the remaining amount of the purchase. In an open-system gift card transaction, however, the issuer will likely deny the purchase authorization if the purchase amount exceeds the balance on the gift card. In that case, the retailer (or customer) must contact the issuer to obtain the balance information and then resubmit an authorization request for only the amount remaining on the gift card. The balance inquiry may also be subject to fees, depending on the gift card agreement.

This participant also mentioned challenges when customers return or cancel a purchase made with an open-system gift card. Based on experiences with closed systems, customers frequently expect immediate credit. For open-system cards, however, it may take several days for the issuer to release funds unless the retailer calls the issuer at that time and provides information about the transaction. This participant, emphasizing how critical the point-of-sale experience is to retailers, stated that when problems with purchases or returns occur, customers frequently associate that poor experience with the retailer rather than the gift card issuer or the processing network.

Another participant noted that some issuers have begun to provide balance information in the denied transaction message to retailers. Many retail payment terminals, however, are not currently programmed to accept this information. Some participants suggested that issuers and networks should share the cost of upgrading this infrastructure instead of placing the costs solely on the retailer.

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One participant also raised the issue that retailers have little choice but to accept open-system gift cards if they also accept debit cards because of conditions imposed by the card networks. Another participant expressed frustration with the cost of accepting open-system gift cards. This participant believed that the merchant fees assessed to retailers were excessively high for a product that was paid in advance to the issuer and thus carried lower risk than, for example, credit cards. For these reasons, this participant explained that retailers have little incentive to upgrade their infrastructure to facilitate open-system gift card use, especially because open-system cards compete with retailers' gift cards.

One participant suggested that, in hindsight, more information could have been provided at an earlier stage to consumers and retailers regarding the current features and limitations of open-system gift cards. The same participant also mentioned a continuing need to better inform retailers about new products. Another participant recommended that it would help to consult retailers about future developments of open-system prepaid cards.

Laws and Regulations

Participants cited a lack of clear and consistent federal or state legal and regulatory requirements for prepaid products. Participants stated that uncertain legal and regulatory conditions may stifle innovation in the industry, as compliance with an increasing number of

laws and regulations, particularly at the state level, may make products too expensive to offer. Participants also remarked that current regulations do not adequately differentiate between types of prepaid products, which may have very different risk characteristics for the general public.

The growth and development of prepaid products have increasingly gained the attention of federal and state legislators and regulators. Over the past several years, states in particular have introduced an increasing number of laws aimed at prepaid products. States have also attempted to clarify whether existing laws cover prepaid products. Participants stated that the proliferation of laws and regulations has caused significant confusion for the industry. One participant noted that because laws and regulations are being enacted piecemeal, they conflict with each other at times, making adherence to all rules and regulations difficult and costly. Another participant predicted that if all prepaid card programs were regulated at the federal level, and not the state level, that the cost of regulatory compliance would ultimately decrease. Other participants expressed concern that greater federal and state regulation could hinder market development. These participants instead stressed the need for greater consistency among existing laws and regulations and their interpretation.

Participants cautioned that additional regulations could ultimately lead businesses to discontinue offering some products and could reduce the development of new products. They noted that some providers are hesitant to provide new prepaid products because of regulatory cost concerns and warned that if certain proposed changes to regulations were implemented, some providers would exit the prepaid market. Participants highlighted three examples of laws and regulations that they believe could increase operating costs and potentially inhibit future innovation in the prepaid market: an expansion of Regulation E's periodic statement requirements, an FDIC ruling that funds underlying prepaid products constitute deposits for FDIC purposes, and the uncertain applicability of some state money transmitter laws.

One participant noted concerns about the periodic statement requirement in Regulation E, which would apply to payroll cards if the Federal Reserve Board adopts its proposed rule.⁴ Some participants stated that payroll cardholders tend to be more transient than the general population and thus it is likely to be costly and challenging to supply periodic statements through the mail. One participant argued that by the time the cardholders received the account information, it would be out of date and thus of little use. Another participant stated that because payroll cards are not deposit accounts, there should be greater flexibility in providing periodic statements.

Participants also raised concerns that the periodic statement requirements in Regulation E would be applied to other types of prepaid products, specifically gift cards. Participants warned that providers would exit the gift card market if periodic statements became mandatory. Participants also noted that providers have no way of knowing the identity of the gift card receiver and often do not track the identity of the gift card purchaser, thereby making it difficult or impossible to provide periodic statements.

Several attendees mentioned the FDIC proposal to consider funds underlying prepaid products as deposits for FDIC purposes.⁵ While one participant thought that this proposal was inconsistent with the FDIC General Counsel's previous opinion, it appeared that participants were somewhat less concerned with the specific proposal as it might be applied by the FDIC than with the widespread implications of the proposal for other regulatory authorities. For instance, one participant noted that some regulators, particularly state

regulators, were suggesting that their regulations should conform to the FDIC's definition of deposit. Following the FDIC proposal, some states began claiming that the issuing and reloading of prepaid products constituted accepting deposits, which implies that issuing locations may be engaged in branch banking. This participant explained that the intent of the FDIC proposal was to define the underlying funds as deposits for FDIC purposes only and not to define the funds as deposits for all purposes. Another participant recommended that the Federal Reserve Board issue a clarifying statement in light of the FDIC proposal regarding the definition of a deposit under Regulation D, which relates to reserve requirements.

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Some participants also expressed concerns over state money transmitter laws as they relate to prepaid products. In 2001, a provision of the U.S. Patriot Act amended the United States Code on crimes and criminal procedure, making it a federal crime to illegally operate an unlicensed money transmitter business in a state that requires a license—regardless of knowledge of the state law. Some state money transmitter laws, however, are not clear about whether they apply to prepaid products. This lack of clarity is a significant concern for nonbanks and state-chartered banks. One participant also noted that one state is challenging whether national banks should be subject to its money transmitter requirements, if the bank offers prepaid products in its jurisdiction. This participant expressed the view that national banks should not be subject to money transmitter requirements because federal law preempts state law requirements. This participant further stated that the only way to confirm that there is federal preemption for national banks might be to sue the state, something that banks are reluctant to do.

Conclusion

Significant changes are taking place in the payments system.⁵ The growth of electronic prepaid products over the past few years is just one example of the changes taking place. This change is the result of changing payment habits and business opportunities, new technology and innovation, and the evolving legal and regulatory framework.

The prepaid card industry is growing, but several challenges remain for market participants. One critical challenge is for providers to achieve economies of scale that would help decrease the costs of providing prepaid products. Currently, prepaid products vary widely in cost and revenue potential, and some products are apparently only marginally, if at all, profitable. Providers also face the challenge of funding upfront investments in technology, infrastructure, and consumer education. Such fixed costs can be difficult for providers to absorb in the short term until the public widely adopts new products. In the past, however, consumers have moved slowly in adopting new payment innovations. Failure to reduce costs, increase profitability, and address some of the business challenges noted above could lead to fewer providers and might ultimately hinder innovation.

Because prepaid products vary significantly, a "one size fits all" regulatory approach may not best fit the needs of the industry or best address the risks associated with these products. The committee encouraged the industry to continue to educate lawmakers and regulators on prepaid products and their characteristics. The committee does not believe that regulation should unduly hinder innovation. The committee also recognized that the industry is concerned about the potential connection between the FDIC proposal to define funds

underlying prepaid products as deposits and Regulation D. The FDIC's rule implements a different statute (the Federal Deposit Insurance Act) with a different purpose than does Regulation D, which implements the reserve requirement provisions of the Federal Reserve Act. The committee noted that the FDIC's definition of deposit would not necessarily predetermine the definition of that term under Regulation D.

In concluding the roundtable, the committee requested that the participants stay in touch with Federal Reserve System staff on developments in the prepaid industry. It also encouraged the participants to identify areas where the committee and other relevant authorities may help to support development of payments system innovation.

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1. The Board of Governors of the Federal Reserve System established the Payments System Development Committee in July 1999. The committee serves as a forum for the analysis of technological and market trends, provides a mechanism for consultation with payments system providers and users, and advises the Board and other Federal Reserve System officials on medium- and long-term public policy issues relating to consumer, government, and corporate payments. In particular, the committee seeks to work collaboratively with the private sector to help identify barriers to innovation in the payments system, identify strategies to enhance the long-term efficiency of existing U.S. payments systems, and develop strategies for transition to the next generation of electronic payments. The members of the committee are Roger Ferguson (co-chair), Vice Chairman of the Board of Governors of the Federal Reserve System, Gary Stern (co-chair), President of the Federal Reserve Bank of Minneapolis, Michael Moskow, President of the Federal Reserve Bank of Chicago, Christine Cumming, First Vice President of the Federal Reserve Bank of New York, and Patrick Barron, First Vice President of the Federal Reserve Bank of Atlanta. [Return to text.](#)
2. The organizations represented at the roundtable were American Express, Bank of America, Federated Department Stores, First Data Corporation, J.P. Morgan Chase, KMZ Rosenman, McKinsey & Company, Morrison and Foerster, TSYS Prepaid, Visa U.S.A., Wegmans Food Markets, and WildCard Systems. [Return to text.](#)
3. "Closed-system" or "private-label" prepaid products are limited to a defined merchant or location (or set of locations), such as a specific retailer or retail chain, a college campus, or a subway system. "Open-system" or "general purpose" prepaid products, such as gift cards, payroll cards, and travel cards, can generally be used at any location that is connected to the particular card network, such as Visa, MasterCard, American Express, or Discover. Although still considered open-system prepaid products, some products restrict where and how the cards may be used. For example, a flexible spending account card can only be used for eligible medical purchases. [Return to text.](#)
4. See Federal Register: September 17, 2004 (Volume 69, Number 180). [Return to text.](#)
5. See Federal Register: April 16, 2004 (Volume 69, Number 74). [Return to text.](#)
6. See the 2004 Federal Reserve payments study. [Return to text.](#)

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